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C O N F I D E N T I A L SECTION 01 OF 04 BEIJING 000557

SIPDIS

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E.O. 12958: DECL: 03/04/2019

TAGS: [ECON](#) [EFIN](#) [CH](#)

SUBJECT: CHINA/G-20: OBJECTIVES AND CONSTRAINTS

REF: A. STATE 17502

- [B.](#) BEIJING 515/443/425/326/151 (INDUSTRY SUPPORT PLANS)
- [C.](#) BEIJING 433 (PROTECTIONISM)
- [D.](#) BEIJING 513/354/08-4481 (MONETARY POLICY)
- [E.](#) BEIJING 484/448/400/281/232 (EMPLOYMENT AND SOCIAL STABILITY)
- [F.](#) BEIJING 471 (FISCAL POLICY)

Classified By: ECON MIN-COUNS Robert Luke. Reasons 1.5 (B and D)

[1.](#) (C) Summary: In the lead-up to the London G-20 Summit, China has clarified that its objectives include: deterring trade and investment protectionism; promoting real economic growth; deflecting public blame for the crisis; protecting its investments; and expanding China's international role. The global financial instability has had a limited direct impact on China's financial infrastructure. China has responded to the downturn in trade with a series of fiscal, monetary, and administrative stimulus packages designed to spur domestic demand and industrial restructuring. China, which already has significant market access restrictions in place, has vociferously opposed new protectionist measures among its trading partners and forgone currency depreciation, allowing its currency to appreciate in trade-weighted terms. In the near term, most economists expect the Chinese economy to remain stalled in the first half of 2009, with a modest recovery likely in the second half. Large-scale unemployment is expected in some sectors, but most observers believe that large-scale unrest threatening regime stability is extremely improbable in the near term. End Summary.

[1.](#) Objectives for the London Summit:

[2.](#) (SBU) China has provided a position paper for the summit. This paper broadly matches its public and private statements on the country's G-20 summit objectives.

Anti-Protectionism

[3.](#) (SBU) Stemming protectionism is the issue of greatest importance to Beijing in the lead up to the London Summit. Officials and local observers have stated repeatedly that they perceive rising protectionist actions and rhetoric around the world, citing measures such as India's restrictions on Chinese toy imports and U.S. Buy American provisions in the recently-passed stimulus package. Beijing's leaders would like concrete anti-protectionist measures on both trade and investment, as well as a positive message on Doha.

Real Economic Growth

[4.](#) (SBU) Beijing is also extremely concerned about the financial crisis' impact on its economy, and particularly on employment. The global financial crisis triggered a sharp rise in unemployment in China, particularly among rural-to-urban migrant workers and recent college graduates. Informal surveys suggest an unemployment rate of 6-10 percent for urban workers overall, 10-20 percent for migrant workers, and 12 percent for college graduates. They seek concurrent macroeconomic stimulus from G-20 members to spur global growth and support employment.

Blame-Avoidance

[5.](#) (SBU) Importantly, the Chinese leadership has an active interest in avoiding accepting any public blame for the financial crisis. They apparently feel that portraying the crisis as an external shock is essential to managing the

crisis politically. While officials have privately acknowledged that China's economic imbalances contributed to global macroeconomic instability, they have rejected vociferously any public attempts to apportion some of the blame for the crisis on China. China will likely reject any language on the need to address global macro imbalances moving forward, and are interested in reforms that emphasize the need for increased regulation on financial innovation in the developed countries.

16. (SBU) In that spirit, China has proposed a wide range of
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broadly-sketched reforms aimed at increasing oversight and regulation of financial products. They recommend strengthened international accounting standards, increased prudential regulation of cross-market risks, and stronger IMF surveillance of the major reserve-currency economies.

Investment Protection

17. (SBU) The Chinese government is heavily invested overseas. While most of its U.S. dollar-denominated investments are in U.S. Treasury securities, a portion is invested in agency and corporate debt, as well as equities. This includes large stakes in financial firms such as Blackstone and Morgan Stanley. The government has expressed concerns that, as governments provide financial relief to their national financial institutions, the rights of overseas investors at times have been diluted. They seek a statement calling for equal protection for all investors.

International Role

18. (SBU) China has long been frustrated by international financial institutions that apportion voting shares that no longer reflect countries' relative economic weightings in the global economy. They would like reapportionment of voting shares within international organizations including the IMF and World Bank, as well as membership in the Financial Stability Forum. Beijing also seeks an endorsement of regional financial cooperation fora, which would in practical terms be an endorsement of a nascent but growing Asian financial architecture.

II. Financial Impact of the Global Financial Crisis

19. (SBU) China's regulated financial sector had less exposure to industrialized countries' financial sectors. Chinese consumers have very low debt and mortgages. The crisis has made Chinese financial regulators more reluctant to promote financial innovation, though they have continued to move forward in selected areas such as corporate bond markets. China's financial regulators had been looking to the West as a template for financial regulation, but recent events have cast doubt on the wisdom of following this course.

III. The Broader Economic Crisis

Impact

10. (SBU) China thus far has avoided the worst of the global financial crisis now engulfing most developed and developing countries. But the economy has slowed dramatically. Economic growth basically stalled in 4Q 2008, with exports, industrial production, and corporate investment (especially in construction and new productive capacity) down sharply. Trade dependent sectors and regions have suffered more than others, and are unlikely to see improvement in the near term.

Exports are contracting, primarily as external demand for higher-value added products has fallen. Availability of trade finance seems to be an indirect problem for small and medium enterprises (SMEs) in China's major export centers, primarily because their overseas buyers have difficulty obtaining financing in their home countries for their imports from China.

Reaction

11. (SBU) The government moved quickly to support growth. In November, the Chinese Government unveiled a fiscal stimulus package to boost the economy, promote consumption, and create jobs. The majority of direct spending is aimed at large-scale infrastructure project across a wide range of sectors. In addition, the stimulus plan incorporates tax reform, monetary stimulus in the form of interest rate cuts and lowered bank reserve ratios, administrative measures to assist housing markets, and most importantly removal of binding quotas on loan growth. While the headline figure of four trillion Renminbi (USD 585 billion) was widely touted, this includes some existing expenditures. For 2009, due to increased expenditures from the stimulus and falling revenues due to lower economic growth, China expects its overall

budget deficit (including central and local governments) to rise to 3.0% of GDP, compared to 0.5% in 2008.

12. (SBU) In January, the Government began to roll out industrial support plans for ten sectors (steel, autos, textiles, etc.) hurt by the economic downturn, although the plans are fairly vague and not all firms will benefit. China also announced an additional RMB700 billion in health care spending, and roughly RMB100 billion to encourage innovation. Senior leaders say more measures will follow if needed.

Protectionism

13. (SBU) The economic downturn has driven home to Beijing its reliance on its housing and export sectors for recent growth. As a result, Beijing has been extremely sensitive to any sign of formal trade or investment protectionism among its trading partners. The official media's harsh reaction to the Buy American provisions is just one example of this sensitivity.

14. (SBU) That said, China already had substantial limits on foreign investment. Likewise, Chinese government procurement law is opaque and fundamentally biased towards local procurement. Some local governments have taken this a step further and sought to restrict foreign participation in local stimulus initiatives, or to initiate "buy local" measures.

15. (SBU) Despite substantial pressure from the export lobby to let the Renminbi depreciate to improve export competitiveness, the Chinese government has held it relatively unchanged against the US dollar. Given the sharp fall in the Euro and other Asian currencies (ex-Japan) this has led to an appreciation on a trade weighted basis. Chinese leaders have stated that they do not believe the exchange rate can play an important counter-cyclical role, since the decline in exports has been due mainly to weak external demand not the lack of price competitiveness, and depreciation could provoke a serious protectionist backlash.

IV. Near-term Outlook

Economy

16. (SBU) The Chinese economy is likely to remain stalled in the first half of 2009, the impact of its fiscal and monetary stimulus could lead to a modest recovery in the second half of this year. Moreover, while China is experiencing a sharp cyclical downturn, there is no financial crisis, as banks continue to lend (albeit to state-owned enterprises and infrastructure projects with implicit central government guarantees). Due in part to the falling price of imported commodities, China is likely to experience periods of deflation this year, further boosting real incomes. Most foreign economists are predicting 6-7% growth for the entire year, driven mainly by the government's infrastructure spending.

17. (SBU) While the sharp decline in external demand has catalyzed a consensus among policy makers that China must rely increasingly on domestic demand for future growth, many believe that achieving sustained domestic demand-led growth will take many years. In a recent survey, a majority of Chinese economists predicted that economic stagnation in the developed world could last up to ten years. Many Beijing analysts are privately concerned that China's fiscal and monetary stimulus will not be sufficient to counteract the continued negative external shock. Most Chinese economists are confident that China can maintain fairly stable growth this year and next.

18. (SBU) In the medium term and beyond, a return to the robust GDP growth rates of recent years will depend on successful rebalancing of the Chinese economy as well as recovery in key overseas markets. Such rebalancing should inevitably lead to a lower rate of accumulation of foreign reserves, including Treasuries. Such a development would help rebalance the overall financial relationship between China and the United States.

Employment

19. (SBU) The global financial crisis has triggered a sharp rise in unemployment in China, particularly among rural-to-urban migrant workers and recent college graduates. The government's stimulus plan, with its emphasis on infrastructure projects, is aimed to large degree at

supporting employment for low-skilled manual laborers. The government has endorsed a series of measures to protect jobs by reducing financial burdens on employers, and to assist the unemployed with job placement, vocational training and loans to start their own businesses. Some of these measures are funded out of unemployment insurance programs, which have been in surplus for years.

120. (SBU) There are programs underway to attempt to expand social safety net coverage to previously uncovered groups (e.g. health care for the urban unemployed), but only on a pilot basis. Experts on the social safety net are deeply disappointed with a draft Social Insurance Law, made public in December 2008, which mainly codifies the status quo and maintains separate and unequal urban and rural systems. Draft regulations published in February 2009, may eventually make social insurance more portable and accessible for migrant workers, but many details remain to be clarified.

Political Stability

121. (C) Rising unemployment linked to the global economic crisis has heightened Chinese leaders' long-standing social stability concerns due to public dissatisfaction over uneven growth, unequal income distribution and rampant corruption, among other issues. Nevertheless, most observers agree that China's ruling Communist Party has the resources and the will to deal with any rise in social unrest in the coming year, and that large-scale unrest threatening regime stability is virtually unthinkable in the near term.

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